

MAY 15 1992

IN THE UNITED STATES BANKRUPTCY COURT, BARON GRUSHON
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
CHARLOTTE DIVISION
Deputy Clerk

IN RE:

JAMES D. CRAWFORD,

Tax I.D. No. [REDACTED]-4497

Debtor.

Case No. C-B-91-31786-GRH

JAMES D. CRAWFORD, by and
through his Guardian,
THERESA ANNIE CRAWFORD,

Plaintiff,

5/19/92

vs.

Adversary Proceeding
No. 91-3505

HOSPITALITY GROUP OF
HICKORY, INC.,

Defendant.

ORDER DENYING DEFENDANT'S REQUEST FOR JURY TRIAL

This matter was heard before the undersigned Bankruptcy Judge on May 14, 1992, upon the defendant's request for a jury trial of this adversary proceeding, and the plaintiff's objection thereto. The Court has reviewed the record in this cause, including but not limited to the pleadings and the legal memoranda filed by the parties, and has heard the arguments of counsel, and being fully informed and advised, the Court finds that the defendant filed a permissive counterclaim in this adversary proceeding, which is tantamount to filing a claim against the estate, and, in so doing, the defendant has consented to the equitable jurisdiction of this Court and thereby has lost any right to a jury trial of this adversary proceeding. The Court concludes that defendant's request for jury trial should be denied.

It is therefore ORDERED that defendant's request for a jury trial of this adversary proceeding is hereby denied.

This 15th day of May, 1992.

George R. Hodges
George R. Hodges
United States Bankruptcy Judge

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HICKORY, INC.,

Defendant.

Case No. C-B-91-31786-GRH

BY: [Signature] GROSHON
Clerk

BRIEF IN SUPPORT OF
DEBTOR'S OBJECTION TO
DEFENDANT'S REQUEST
FOR JURY TRIAL

Adversary Proceeding
No. 91-3505

I. STATEMENT OF THE CASE

For a period of approximately four years prior to March 15, 1991, James D. Crawford ("Crawford") was employed as Vice President of Hospitality Group of Hickory, Inc. ("Hospitality"). As of March 15, 1991, he owned 33,513 shares of Hospitality stock. On March 15, 1991, certain officers and shareholders of Hospitality accused Crawford of embezzling funds in an undetermined amount alleged to be between \$50,000 and \$100,000. They told Crawford that if he would transfer his Hospitality stock back to Hospitality, they would not press charges or file any civil claims against him based on the embezzlement. Unrepresented by counsel and faced with a deadline of only several hours to make his decision, Crawford agreed to the stock transfer and signed a release to that effect.

(24)

Subsequent to signing the release, Crawford attempted to commit suicide and was declared mentally incompetent. His wife, Annie Crawford, as general guardian, filed a Chapter 11 petition on August 21, 1991. On November 7, 1991, Annie Crawford, on behalf of her husband, filed an adversary proceeding against Hospitality seeking the following:

1. Recision of the release and stock transfer documents on grounds that Crawford was mentally incompetent at the time he signed them;
2. Avoidance of the stock transfer as a fraudulent conveyance under Section 548 of the Bankruptcy Code; and
3. Avoidance of the stock transfer on grounds of unjust enrichment.

Hospitality filed an answer and counterclaim, seeking to recover the amounts allegedly embezzled. In its answer, Hospitality also requested a jury trial. This matter is before the court on Hospitality's request for a jury trial, and Crawford's objection to that request.

II. QUESTIONS PRESENTED

1. By filing a counterclaim in this action for pre-petition damages, did Hospitality consent to the equitable jurisdiction of the bankruptcy court and thereby lose any right it may have had to a jury trial?
2. Does Hospitality fail to satisfy the Granfinanciera requirements for entitlement to a trial by jury on grounds that Crawford seeks an equitable remedy consisting of the return of stock or the value thereof, rather than the legal remedy of specific money damages?

III. CONCLUSION

Hospitality consented to the equitable jurisdiction of the bankruptcy court in this adversary proceeding when it filed a counterclaim seeking sums allegedly embezzled by Crawford pre-petition. Recent decisions of the United States Supreme Court make

clear that a creditor who files a proof of claim against a bankruptcy estate consents to the equitable jurisdiction of the bankruptcy court, and thereby loses any Seventh Amendment right the creditor may have had to a jury trial in an adversary proceeding. See Granfinanciera v. Nordberg, 49 U.S. 33, 109 S.Ct. 2782, 106 L.E.2d 26 (1989) and in Langenkamp v. Culp, 111 S. Ct. 330, 331 (1990). Subsequent bankruptcy and federal district court cases applying Granfinanciera and Langenkamp show that a creditor loses its right to a jury trial by asserting a counterclaim in an adversary proceeding, as well as by filing an official proof of claim. In addition to the bankruptcy and federal district court cases, the applicability of Granfinanciera and Langenkamp to counterclaims can be seen in: (i) the fact that the Bankruptcy Code defines the term "claim" broadly to encompass virtually all legal or equitable rights to payment against the estate; (ii) the cases applying the principle of jurisdiction by consent when a creditor asserts an affirmative claim for relief, rather than filing an official proof of claim; and (iii) the fact that a counterclaim against the debtor for pre-petition damages in an adversary proceeding is the functional equivalent of a proof of claim.

Even aside from the counterclaim issue, Hospitality is not entitled to a trial by jury in this action because the remedy sought by Crawford is equitable in nature. In determining whether a party is entitled to a jury trial in an adversary proceeding, courts examine: (i) whether the claims comprising the adversary proceeding would have been actions at law in England in 1791; (ii) whether the remedy sought in the proceeding is legal, rather than

equitable in nature; and (iii) whether Congress assigned resolution of such claims to the bankruptcy court. The second prong of this test is the most important, and Hospitality fails to satisfy it.

In this case, Hospitality fails to satisfy the second prong of the Granfinanciera test because Crawford seeks equitable, rather than legal, remedies. If Crawford prevails in this adversary proceeding, his remedy will consist of either return of his stock or payment of its value, which must be determined through an equitable accounting. In either event, the law characterizes the relief Crawford seeks as equitable in nature. Accordingly, the remedy sought by Crawford takes this adversary proceeding outside the scope of the Seventh Amendment right to a jury trial.

IV. ARGUMENT

A. Hospitality Has No Right To a Jury Trial In This Adversary Proceeding Because It Consented To The Equitable Jurisdiction of the Bankruptcy Court By Filing A Counter-claim.

Two recent Supreme Court cases make clear that a creditor who files a claim against the estate loses its right to a jury trial in an adversary proceeding. In Granfinanciera v. Nordberg, 49 U.S. 33, 109 S. Ct. 2782, 106 L.E.2d 26 (1989), the Supreme Court acknowledged that a creditor who files a claim against a bankruptcy estate "triggers the process of allowance and disallowance of claims, and thereby subjects himself to the bankruptcy court's equitable jurisdiction." Granfinanciera, 109 S. Ct. at 2798-2799. In Langenkamp v. Culp, 111 S. Ct. 330, 331 (1990), the Supreme Court took Granfinanciera one step further by holding that a creditor's filing of a claim against a bankruptcy estate constitutes consent to the equitable jurisdiction of the bankruptcy

court, and eliminates any Seventh Amendment right the creditor may have had to a jury trial in an adversary proceeding brought by the trustee. As stated by the Court in Langenkamp:

In Granfinanciera we recognized that by filing a claim against a bankruptcy estate the creditor triggers the process of "allowance and disallowance of claims," thereby subjecting himself to the bankruptcy court's equitable power. If the creditor is met, in turn, with a preference action from the trustee, that action becomes part of the claims-allowance process which is triable only in equity. In other words, the creditor's claim and the ensuing preference action by the trustee become integral to the restructuring of the debtor-creditor relationship through the bankruptcy court's equity jurisdiction.
(citations omitted)

Id. In this case, the counterclaim filed by Hospitality renders this adversary proceeding integral to the restructuring of the debtor-creditor relationship, and thus bars any right Hospitality may have had to a jury trial.

Courts in at least three cases subsequent to Granfinanciera have held that a defendant in an adversary proceeding loses its right to a jury trial by filing a counterclaim. In Bayless v. Crabtree through Adams, 108 B.R. 299 (W.D. Okl. 1989), aff'd, 930 F.2d 32 (10th Cir. 1991) the court held that the defendants in a turnover action which hinged on state law issues submitted themselves to the equitable jurisdiction of the Bankruptcy Court and lost their right to a jury trial by filing a counterclaim against the estate. In reaching its decision, the court in Bayless made the following comments:

The Crabtree Children acknowledge that their counterclaim may be the equivalent of an informal proof of claim. The term "claim" under the bankruptcy laws includes virtually

all legal or equitable rights to payment and is broadly construed. Moreover, written proofs of claim need not adhere to the official forms to be acceptable. Furthermore, the Court notes that the principal of jurisdiction by consent discussed above had been held applicable where, instead of a proof of claim, the creditor asserts a claim for affirmative relief. Thus, in any event, by filing their counterclaim, the Crabtree Children submitted to the equitable jurisdiction of the Bankruptcy Judge. (citations omitted)

Bayless, 108 B.R. at 305. The Tenth Circuit recently affirmed the Bayless decision.

Likewise, in In Re Glen Eagle Square, Inc., 132 B.R. 106, 112-113 (Bkrtcy. E.D. Pa. 1991), the court held that a general contractor who asserted counterclaims in an adversary proceeding filed against it by the debtor in connection with a construction contract lost its right to a jury trial under the Seventh Amendment. While the contractor in Glen Eagle Square did file a proof of claim after the debtor brought the adversary proceeding, the court based its denial of a jury trial on both the counterclaims and the proof of claim, independent from each other. Id., 132 B.R. at 112-113. In reaching its decision, the court noted that when the contractor filed counterclaims in the adversary proceeding, it chose the equitably-based bankruptcy forum as the situs to resolve its disputes and lost any right it may have had to a jury trial. Id. 132 B.R. at 113.

Similarly, in In re Allied Companies, Inc., 137 B.R. 919 (S. D. Ind. 1991), the United States District Court held that a creditor's counterclaim in a preference action barred the creditor from demanding a trial by jury. In Allied Companies, the cred-

itor's counterclaim sought reclamation of certain goods, or alternatively, that the creditor be deemed to have a priority claim or that a lien be placed on the debtor's property. Id. at 920. Noting that the counterclaim asserted claims against the estate, the court stated:

. . . this court can conclude that where, as here, the relief sought implicates the bankruptcy court's . . . process of allowance and disallowance of claims," and requires the court to take "action integral to the restructuring of debtor-creditor relations," this counterclaim for reclamation of goods or for a priority claim or lien invokes what are apparently public, rather than private, rights and that therefore, no jury is required by the Seventh Amendment. (citations omitted)

Id. at 922; quoting in part Granfinanciera, 109 S. Ct. at 2799.

In addition to the cases cited above, the applicability of Granfinanciera and Langenkamp to Hospitality's counterclaim in this case can be seen in the definition of the term "claim" under the Bankruptcy Code. As defined in 11 U.S.C. 101(5) and construed by the courts, the term "claim" encompasses virtually every legal or equitable right to payment against a debtor's estate. Bayless v. Crabtree Through Adams, 108 B.R. 299, 305 ((W.D. Okl. 1989); citing In re Thomas, 12 B.R. 432, 433 (Bkctcy. S.D. Iowa 1981); 2 L. King, Collier on Bankruptcy §101(4). Hospitality's counterclaim falls squarely within this definition.

In addition, an alleged right to payment need not be asserted on an official proof of claim form to qualify as a "claim." Bayless at 305; citing 8A C.J.S. Bankruptcy § 276 (1988). To the contrary, the principle of jurisdiction by consent applies where,

instead of a proof of claim, the creditor asserts a claim for affirmative relief. See Bayless at 305; citing In re Panama-Williams Corp., 235 F. Supp. 729, 733 (S.D. Tex. 1964) (Consent to have controversy between adverse parties adjudicated in bankruptcy court may be express, may be by waiver through failure to make the proper objection, or may be implied from any act indicating willingness of party that his claim be determined by bankruptcy court). See also Cresenzi Bird Importers, Inc. v. State of New York, 831 F.2d 410, 414-418 (2d. Cir. 1987) (filing of lawsuit against the debtor in bankruptcy court is, in effect, a filing of a proceeding regarding allowance or disallowance of claims against the estate). Other cases hold that the debtor consents to the equitable jurisdiction of the bankruptcy court by filing a petition or taking other actions such as filing a counterclaim or a noncore adversary proceeding. See, In re Manning, 71 B.R. 981, 987 (Bkctcy. N.D. Ala 1987) (a pre-Granfinanciera case holding that debtor waives right to jury trial by filing counterclaim); Matter of Hallahan, 936 F.2d 1496, 1505 (7th Cir. 1991) (debtor consents to jurisdiction of bankruptcy court by filing bankruptcy petition and thereby waives right to jury trial); In re Haile Co., 132 B.R. 979 (Bkctcy. S.D. Ga. 1991) (debtor waived constitutional right to a jury trial by bringing noncore adversary proceeding in bankruptcy court).

In this case, Hospitality's counterclaim is the functional equivalent of a proof of claim. As seen in Bayless, Glen Eagle Square and Allied Companies, no basis exists for distinguishing

between Hospitality's counterclaim and a proof of claim for purposes of Langenkamp and Granfinanciera. Both seek to determine how much, if any, a creditor is entitled to receive from the estate. Because both Hospitality's counterclaim and a proof of claim seek to establish a right to payment from the estate, each implicates the bankruptcy court process of allowance and disallowance of claims, and requires the court to take action integral to the restructuring of debtor-creditor relations. In addition, because Hospitality's counterclaim seeks pre-petition damages, it is entirely voluntary under Bankruptcy Rule 7013. Thus, regardless of whether this Court adopts the implied consent rationale underlying Bayless, Glen Eagle and arguably Langenkamp, or the public rights rationale underlying Allied Companies, Hospitality lost any right it otherwise would have had to a jury trial when it filed a counterclaim in this action.

While courts have on occasion found that a defendant does not waive its right to a jury trial by filing a counterclaim, these cases are distinguishable on grounds that such cases pre-date Langenkamp, or that the counterclaims involved were compulsory under Bankruptcy Rule 7013. For instance, in Beard v. Braunstein, 914 F.2d 434 (3rd Cir. 1990) the trustee brought an adversary proceeding against a tenant of the debtor to collect rents due, and the tenant denied liability and counterclaimed for damages purportedly caused by the poor condition of the leased buildings. The court found that because the tenant missed the bar date for filing a claim for pre-petition damages, the only damages recover-

able under the counterclaim were those that arose post-petition. Citing Bankruptcy Rule 7013, the court then observed that a counterclaim for post-petition damages is compulsory, and that a defendant does not waive his right to a jury trial by asserting a compulsory counterclaim. Id. at 442. By basing its decision its on the compulsory nature of the counterclaim, the court in Beard implied that it would reach a different result for a permissive counterclaim. In this case, Hospitality's counterclaim is permissive under Bankruptcy Rule 7013 because it seeks pre-petition damages. Accordingly, Beard provides no authority to support Hospitality's request for a jury trial.

For the foregoing reasons, Hospitality subjected itself to the equitable jurisdiction of the bankruptcy court when it filed a counterclaim in this action. Hospitality's counterclaim is the functional equivalent of a claim against Crawford's estate. As seen in Bayless, Glen Eagle Square and Allied Companies, no basis exists for distinguishing between Hospitality's counterclaim and a proof of claim. Both ask the Court to determine the allowance or disallowance of Hospitality's claim against the estate. Furthermore, because Hospitality's counterclaim seeks pre-petition damages, it is entirely voluntary. Thus, by filing its counterclaim, Hospitality lost any right it otherwise would have had to a jury trial.

B. Hospitality has no right to a trial by jury because the relief sought in the adversary proceeding is equitable, rather than legal in nature.

Even if Hospitality had not subjected itself to the equitable jurisdiction of the bankruptcy court by filing a counterclaim, it is not entitled to a jury trial under the analysis established by Granfinanciera v. Nordberg, 49 U.S. 33, 109 S.Ct. 2782, 106 L.E.2d 26 (1989). In Granfinanciera, the Supreme Court established the following three factors as determinative of whether a creditor has a right to a trial by jury in an adversary proceeding:

First, we compare the statutory action to 18th-century actions brought in the courts of England prior to the merger of the courts of law in equity. Second, we examine the remedy sought and determine whether it is legal or equitable in nature. The second stage of this analysis is more important than the first. If on balance, these two factors indicate that a party is entitled to a jury trial under the Seventh Amendment, we must decide whether Congress may assign and has assigned resolution of the relevant claim to a non-Article III adjudicative body that does not use a jury as a fact finder. (emphasis added).

Id. 109 S.Ct. at 2790. In this case, Hospitality fails to satisfy the second prong of this test because the remedy Crawford seeks is equitable, rather than legal in nature.

In Granfinanciera the Supreme Court stated that a remedy is legal in nature when the Plaintiff seeks simple monetary damages, such as in an action "sounding in tort or for money had and received." Granfinanciera, 109 S.Ct. at 2793; quoting Buzard v. Houston, 119 U.S. at 352, 7 S.Ct. at 252, citing Parkersburg v. Brown, 106 G.S. 4878, 500, 1 S.Ct. 442, 452, 27 L. Ed. 238 (1883). As stated by the scholarly authority adopted by the court in Granfinanciera:

If the subject matter is a chattel, and is still in the Grantee's possession, an action in trover or replevin would be the trustee's remedy; and if the fraudulent transfer was of cash, the trustee's action would be for money had and receiv-

ed. Such actions at law are as available to the trustee to-day as they were in the English Courts of long ago. If, on the other hand, the subject matter is land or an intangible, or the trustee needs equitable aid for an accounting or the like, he may invoke the equitable process, and that is also beyond dispute.

Granfinanciera, 109 S.Ct. at 2791; citing, 1 G.Glenn, Fraudulent Conveyances and Preferences §98, pp. 183-184 (rev. ed. 1940).

Applying this standard, the court in Granfinanciera held that because the trustee sought specific money damages in his Section 548 fraudulent conveyance claim, the relief sought was legal in nature, rather than equitable. Granfinanciera, 109 S.Ct. at 2793-2794.

Unlike the specific money damages sought by the trustee in Granfinanciera, Crawford in this case seeks return of his stock or the value thereof. Crawford's stock is an intangible asset. According to the authority cited in Granfinanciera, the return of an intangible asset constitutes an equitable remedy. Granfinanciera, 109 S.Ct. at 2791. Likewise, if Crawford obtains the value of his stock rather than its actual return, the determination of that value will require what the authority cited in Granfinanciera referred to as "an equitable accounting or the like." Thus, the remedies sought by Crawford in this case are equitable in nature. Because the nature of the remedies constitutes the most important criteria in the Granfinanciera analysis, Hospitality fails to satisfy the requirements for entitlement to a jury trial.

Sources outside of Granfinanciera further confirm that the remedies sought in this case are equitable in nature. In a bankruptcy case prior to Granfinanciera which struggled with the

same Seventh Amendment right to jury trial issues, the court made the following remarks in explaining that a claim for breach of fiduciary duty is legal in nature:

It may be contrasted with the type of relief which might be sought in a court of equity, such as praying for an accounting, or that a transaction be voided and set aside . . .

In re Manning, 71 B.R. 981, 985 (Bkctcy. N.D.Ala 1987). Thus, Manning indicates that the remedies sought in this action are equitable not only because determining the stock value will require an accounting, but also because Crawford seeks to void and rescind the documents transferring his stock to Hospitality.

Because the remedies Crawford seeks are equitable in nature, Hospitality has no entitlement to a jury trial under Granfinanciera. However, even if Hospitality had a right to a jury trial, it lost that right by filing a counterclaim in this action. For the foregoing reasons, Crawford requests that this Court deny Crawford's request for a jury trial.

Respectfully submitted this 11 day of May.

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